loops that BellSouth claims are purchased by AT&T for each wire center that the petition identified as having an AT&T presence (by means of a switch, remote switch, and/or collocation), and the customer segments that (according to BellSouth) AT&T has targeted in each wire center. Such data, for example, would have enabled AT&T to determine whether the number of provisioned loops described in the petition includes loops provisioned to AT&T and to verify BellSouth's assertions regarding collocated facilities (including targeted customer segments) in wire centers where AT&T is claimed to be the sole collocator. By refusing to provide AT&T with the requested data, BellSouth made it impossible for AT&T to verify whether the petition accurately describes the extent of AT&T's collocated facilities, the number and locations of the loops that AT&T has purchased from BellSouth, and the types of customers to which AT&T offers service from specific wire centers.[10]

28. *Second*, the Commission's triggers do not require a showing that the ILEC has lost its market power with respect to each critical component of the access services for which price flexibility is being requested. The Commission explained that it was not imposing such a requirement because (1) "regulation imposes costs on carriers and the public, and the costs of delaying regulatory relief outweigh any costs associated with granting that relief before competitive alternatives have developed to the point that the incumbent lacks market power"; and (2) "non-dominance findings are neither administratively simple nor easily verifiable." *Id.*, ¶¶ 90-91.

29. The Commission's rationales are unpersuasive. Although regulation certainly imposes costs, the costs to purchasers of access services – and ultimately to the end-user customers of those businesses – resulting from premature deregulation can be quite high.

[10] *See* AT&T Opposition To BellSouth Petition For *Phase I* Pricing Flexibility For Switched Access Services, filed (continued)

The Commission offers no basis for its assertion that the costs of delaying regulatory relief outweigh the costs associated with granting that relief before the ILEC lacks market power.[11] Furthermore, although issues relating to the effectiveness of competition may sometimes be complex, the Commission has resolved such issues on a number of occasions in the past – as it acknowledges. *Id.*, ¶ 90 & n.249. More importantly, without requiring a showing that the ILEC lacks market power over all inputs required to provide access services, there is no assurance that the ILEC will not engage in the anticompetitive activities that the Commission seeks to prevent.

30. Thus, the Commission established triggers that do not consider the extent of an ILEC's market power over each individual critical input for the access service involved. In the case of special access services and dedicated transport, the Commission did establish a separate trigger for channel terminations, correctly recognizing that this input requires separate consideration because of the higher investment required for channel termination and the current reliance by alternative providers on the ILECs' facilities for channel terminations. *Id.*, ¶¶ 102-103. The Commission's channel termination trigger, however, looks only at collocation in a percentage of wire centers in the MSA. The trigger does not measure investment by competitors in channel termination facilities; indeed, under this trigger, an ILEC could receive pricing

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September 18, 2000, at 8-9.

[11] At one point in its order, the Commission suggests that the costs of granting pricing flexibility relief without requiring a showing of lack of market power are not substantial because "If an incumbent LEC charges an unreasonably high rate for access to an area that lacks a competitive alternative, that rate will induce competitive entry, and that entry will in turn drive rates down." *Pricing Flexibility Order*, ¶ 144. This rationale ignores both the ability of the ILEC, through its market power, to deter entry through such practices as predatory pricing and the barriers to entry that exist, particularly entry barriers for alternative access providers that seek to provide service exclusively over their own facilities. Moreover, the Commission's rationale is inconsistent with its actions. If unreasonably high prices readily induce other providers to enter the market, the Commission could simply have deregulated pricing of access services unconditionally, without adopting any triggers requiring a showing of competitive activity.

flexibility for channel terminations in a situation where not a single competitor has built any channel terminations anywhere in the MSA.

31. The distinction between channel terminations and dedicated transport, however, constitutes the Commission's sole separation of critical inputs in the context of special access services and dedicated transport. For special access services other than channel terminations and for dedicated transport facilities, the Commission established a *single* trigger – even though, for example, dedicated transport services consist of entrance facilities, direct-trunked transport, and the flat-rated portion of tandem-switched transport. The trigger treats these services as if they constituted but one critical input subject to the same degree of competition, even though they obviously do not, as the Commission itself has admitted. See Forbearance Order ¶ 28. The fact that competition might exist for entrance facilities does not mean that competitive alternatives are available for interoffice transport channels.

32. Instead of reviewing the ILEC's lack of market power over critical inputs, the Commission's triggers for special access services and dedicated transport look at whether competitors have operational collocations in a specified percentage of wire centers or in wire centers accounting for a specified percentage of revenues. The Commission itself acknowledged the "shortcomings" of using collocation as a measure of competition, at least for channel terminations (given the current reliance of competitors on ILECs for channel terminations), but reasoned that collocation "appears to be the best option available to us at this time." *Id.*, ¶ 103.[12] This rationale is perplexing, because the number of wire centers in an MSA where competitors have collocated facilities provides no indication of the extent of the ILEC's market power over

[12] As the Commission recognized, the fact that a competitor has collocated in a particular wire center does not mean that the competitor itself has put channel termination in place to serve special access customers, rather than rely on the ILEC for channel termination facilities. *Pricing Flexibility Order*, ¶ 103.

the critical inputs needed to provide the service. Collocation cannot serve as a reliable measure of the extent of effective, facilities-based competition, because in most instances the collocating competitor is dependent upon the cooperation of the ILEC in order to provide service.

33. For switched access services, the applicable trigger for Phase I relief requires an ILEC to prove that competitors, in the aggregate, offer service "either exclusively or largely over their own facilities" to 15 percent of customer locations in the MSA. *Id.*, ¶¶ 108, 113. Although the trigger does not require proof that the ILEC lacks market power over each critical input needed to provide switched access services, a showing that competitors are providing such services *exclusively* over their own facilities would strongly indicate that the ILEC lacks market power over those inputs, at least in the area of the MSA where they offer service. However, the trigger does not go far enough. In the first place, as discussed more fully below, the 15 percent threshold is too low. The fact that competitors offer totally facilities-based service to such a small portion of all customer locations does not mean that the ILEC lacks market power over the inputs needed to provide switched access services to the *remaining* customer locations.

34. Furthermore, the Phase I trigger can be satisfied as long as competitors provide switched access services using their own switching and transport, even if they also use unbundled loops obtained from the ILEC. *Id.*, ¶ 113. As the Commission itself admitted elsewhere in the Pricing Flexibility Order, however, unbundled loops obtained from the ILEC cannot be treated as the competitor's "sunk" facilities for purposes of the Commission's analysis. As previously stated, an ILEC can exercise market power over an entire service as long as it has market power over *one* of the critical inputs needed to provide the service. The Phase I trigger is thus fundamentally flawed, because it allows pricing flexibility relief even when the

"competitors" allegedly offering switched access services are subject to exclusionary behavior and pricing as a result of their dependence on the ILEC for unbundled loops.

35. The failure of the Commission's triggers to review the presence or lack of market power for each critical input or component of the access service is a serious deficiency. As long as any of these necessary inputs is not subject to potential competition, BellSouth and other ILECs will, absent regulatory restraints, be able to charge supracompetitive prices for access services. The evidence of record suggests, in fact, that many inputs required for the provision of access services are available only from the ILEC. For example, in the BellSouth region, AT&T makes **REDACTED** percent of its payments for channel terminations, and **REDACTED** percent of its payments for dedicated transport, to BellSouth.[13] In defending the use of a collocation-based trigger, the Commission itself appeared to recognize that ILECs currently have market power over channel terminations in the provision of access services.[14]

36. Unless barriers to entry are extremely low, these facts suggest strongly that an overwhelming majority of special access customers are captive customers that could be charged unreasonably high rates if BellSouth's petition for pricing flexibility for special access is granted. The available evidence, however, suggests that barriers to entry in the provision of many of these inputs are substantial. For example, the evidence suggests that the barriers to entry in the provision of LDCs – essentially local loops to large business customers – are high

[13] *See* Declaration of Charles E. Stock filed this date as part of AT&T's motion for a stay ("Stock Declaration"), ¶¶ 4, 8.

[14] "[A] competitor collocating in a LEC end office continues to rely on the LEC's facilities for the channel termination between the end office and the customer premises, at least initially, and thus is susceptible to exclusionary pricing by the LEC." *Pricing Flexibility Order*, ¶ 103 (footnote omitted). Although the Commission stated that it "seems likely" that competitors would depend on ILECs for channel termination "only on a transitional basis and will eventually extend [their] own facilities to reach [their] customers" (*id.*, ¶ 104), the possibility that competitors might use their own facilities at some unknown future date does not alter the Commission's basic conclusion that, currently, ILECs have market power over channel terminations.

enough to enable ILECs such as BellSouth to maintain a very high share of LDCs while charging already supracompetitive prices. As the Commission has recognized, new entrants in the BellSouth region face significant impediments to building LDCs and entering the market quickly. New entrants are charged rights-of-way fees by building owners that BellSouth was not (or is not) charged; new entrants are charged rights-of-way fees by municipal governments that BellSouth was not (or is not) charged, or are unable to procure such rights-of-way altogether; new entrants are forced to endure lengthy waits to get municipal rights-of-ways; in many existing buildings, there is simply no space (or power) for redundant facilities even if the building owner is otherwise willing to permit them; and many building owners will not permit AT&T and other prospective providers of special access to connect a customer to its network but instead require them to pay BellSouth for that work. Last, but definitely not least, LDCs are characterized by large fixed and sunk costs, thus limiting competition to only the extremely high-volume users.[15]

37. Dedicated transport facilities provide yet another example of inputs needed to provide special access services where barriers to entry are considerable. Although some competitors may have put in place dedicated transport facilities in some areas of the BellSouth region, the costs of deploying these facilities are sufficiently high so that it is economic for AT&T and other competitors to serve only the special access customers with the greatest demand. .[16]

[15] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order, 15 FCC Rcd. 3696 (¶¶ 182-87) (1999) ("*UNE Remand Order*") ("as a practical matter, building loop plant continues to be, in most cases, prohibitively expensive and time-consuming," and the fact "[t]hat some [CLECs], in certain instances, have found it economical to serve certain customers using their own [high-capacity DS1] loops suggests to us only that carriers are unimpaired in their ability to serve those particular customers"); *Promotion of Competitive Networks in Local Telecommunications Markets, et al.*, WT Docket No. 99-217, Notice of Proposed Rulemaking, 14 FCC Rcd. 12673 (¶¶ 21-24, 29-35, 52-63) (1999);

[16] UNE Remand Order ¶¶ 355-56, 359. More precisely, although competitors have installed transport limited facilities at the DS3 level – the type of facilities for the largest special access customers – these facilities serve only

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38. *Third*, the triggers established by the Commission in the *Pricing Flexibility Order* do not require that the evidence be consistent with the relief sought. As noted, access services are demanded and supplied on a point-to-point basis. Accordingly, the Commission must assure that the geographic scope of any request for pricing flexibility matches the geographic scope of demonstrated price-constraining competitive alternatives. Even significant competition in one part of an MSA does not protect consumers in areas where little or no such competition exists.

39. The Commission's triggers, however, do not require ILECs to show that price-constraining competition exists across the entire MSA. Instead, the triggers in effect allow an ILEC to exercise market power in substantial portions of an MSA as long as it can show that competitive entry exists in a small portion of an MSA. This approach totally ignores the point-by-point nature of the market demand for these services, and thus leaves substantial portions of an MSA susceptible to anticompetitive practices and exclusionary pricing behavior by the ILECs.

40. In the case of special access services (except channel terminations) and dedicated transport, for example, an ILEC can obtain Phase II relief as long as it can show competitors have operational collocated facilities in 50 percent of the wire centers in the MSA. In fact, the required percentage can be *significantly below* 50 percent as long as the wire centers where competitors are collocated account for at least 65 percent of the ILEC's revenues from these services. Thus, the trigger would allow broad-based pricing flexibility throughout an MSA even when there were only a limited competitive presence (one collocator) in 50 percent of wire

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a small fraction of the demand for such services. At the DS1 level – the facilities that are used economically to serve lower-usage special access customers – competition is almost nonexistent.

centers in that MSA, and no competition whatsoever existed in the other 50 percent of wire centers. Under the alternative revenue-based trigger, the ILEC can obtain relief if competition existed in only a few wire centers that accounted for the specified percentage of revenues.

41. BellSouth's recent petition for pricing flexibility for special access and dedicated transport illustrates this point. For more than 80 percent of the MSAs for which it sought pricing flexibility, BellSouth relied on the "revenue-based" alternate trigger. In some of these MSAs, competition is extremely limited and confined. Two examples are illustrative. In the Asheville, North Carolina MSA, BellSouth seeks Phase II pricing flexibility because the 11 percent of wire centers in that MSA with collocated competitors allegedly account for 75 percent of its revenues from special access and dedicated transport – even though 89 percent of the wire centers have no collocated competitor that uses its own transport. BellSouth also seeks Phase II pricing flexibility for the Gainesville, Florida MSA because 90 percent of its channel termination and special access/dedicated transport revenues are purportedly derived from wire centers where competitors have collocated facilities; yet those wire centers account for only 16.7 percent of all wire centers in the MSA.

42. Regardless of which trigger the ILEC uses as the basis for its application, the grant of pricing flexibility will leave the ILEC free to exploit its market power in those areas of the MSA where competition does not exist. Freed of price regulation, the ILEC will be free to charge monopoly rents to captive customers of special access and dedicated transport while having the ability to manipulate its rates to exclude potential competitors whenever a threat of entry arises.

43. The Phase I trigger for switched access services is similarly deficient, because it only requires an ILEC to show that competitors are offering service to at least

15 percent of customer locations in the MSA either "exclusively or largely" over their own facilities. By setting the bar so low, the trigger allows an ILEC the freedom to use contract tariffs and offer volume and term discounts throughout an entire MSA, even though facilities-based competition does not exist for as many as 85 percent of customer locations in the MSA. In those areas not subject to such competition, the ILEC will be able to practice the very anticompetitive activities that the trigger was intended to prevent.

44. BellSouth's petition for pricing flexibility for switched access services is again illustrative. According to an October 31, 2000 *ex parte* letter to the Commission from BellSouth, in five of the ten MSAs for which pricing flexibility is requested, "facilities-based" competitors (as defined by BellSouth) offer switched access to no more than 15.4 percent of customer locations (and in one of these MSAs, only 6.1 percent of customer locations are offered service). Only in three of the 10 MSAs are more than 40 percent of the customer locations offered service by purportedly "facilities-based" competitors – and even in those MSAs, the percentage of customer locations in noncompetitive areas is substantial (58.9 percent in one MSA, 51.9 percent in the second, and 27 percent in the third).[17] The existence of competition in the limited areas of these MSAs cannot constrain anticompetitive behavior in other areas where competition does not exist.

45. *Fourth*, the Commission's triggers fail to take into account the extent to which the ILEC seeking Phase I or Phase II pricing flexibility has taken advantage of the pricing

[17] The percentages that are set forth in the October 31 BellSouth *ex parte* letter were recalculated from those set forth in Attachment 1 of BellSouth's original petition, which were substantially higher for several of the MSAs because BellSouth had misinterpreted the *Pricing Flexibility Order* as allowing it to include in the percentages the activities of CLECs who relied on BellSouth as the source of their transport. When that error was corrected by BellSouth, a very different competitive picture emerged. Indeed, for four of the 10 MSAs, the recalculated percentages were below the 15 percent threshold that must be met for Phase I relief. Even the percentages in BellSouth's original petition showed that large portions of the 10 MSAs were noncompetitive; for example,

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flexibility already granted by the Commission. In the *Pricing Flexibility Order*, the Commission explicitly rejected the notion that the failure of an ILEC to adjust rates under the geographic deaveraging then permitted and the existing price cap rate structure is not an indication of the lack of meaningful competition. The Commission reasoned, in essence, that its existing pricing rules limited the ILECs' ability to respond to competition. *Pricing Flexibility Order*, ¶¶ 66, 92. That explanation, however, is insufficient from an economic perspective. Despite their limitations on pricing behavior, the existing FCC rules (including the revised rules promulgated in the *Order*) give the ILECs some flexibility to change prices in response to competitive forces. For example, ILECs generally can charge any price for access services as long as the price does not exceed the applicable price cap ceiling; can engage in certain forms of geographic deaveraging; and can offer volume and term discounts under certain conditions. The failure of a CLEC to take advantage of this pricing freedom can be compelling evidence that no effective competitive constraints on the ILEC's prices currently exist.

46. For example, BellSouth has consistently priced its access services – whether special access services and dedicated transport or switched access services – at or near price cap levels, even though it was free to charge lower rates. Stock Declaration, ¶¶ 5,10. BellSouth also has failed to take advantage of the flexibility to deaverage special access and dedicated transport rates, and tandem-switched transport rates, into seven zones per study area, which the *Pricing Flexibility Order* permits without the need to obtain Commission approval. Instead, BellSouth's rates are identical (or virtually identical) in all three of its rate zones. *Id.*, ¶¶ 6, 11. This behavior is difficult to reconcile with BellSouth's current claims that market

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according to Attachment 1 of the petition, in three MSAs no more than 18.7 percent of customer locations were offered service by "facilities-based" competitors (as defined by BellSouth).

forces will constrain its prices for access services to competitive levels even in the absence of regulation, since historical-based price cap levels are generally conceded to be well above forward-looking costs. It is reasonable to infer from its pricing behavior that BellSouth is not subject to effective competition throughout the MSAs for which it seeks pricing flexibility relief. The fact that BellSouth, in the face of these realities, could be granted the relief it seeks would not be in the public interest.

II. Because of Their Failure to Follow Fundamental Methodological Principles, the Triggers in the *Pricing Flexibility Order* Will Enable Price Cap LECs Who Are Granted Pricing Flexibility To Inflict Irreparable Harm on Competitors, Purchasers of Access Services, and End-User Customers.

47. If the incumbent LECs are awarded pricing flexibility under the circumstances contemplated by the Commission's triggers, the predictable effect will be to essentially freeze competitive entry into the access market at present levels, while simultaneously allowing the incumbents to raise their generally applicable rates to monopoly levels without regulatory restraint. This would result in several forms of irreparable harm, to competitors, to purchasers of access services, and to end user customers.

48. Consistent with the pro-competitive objectives of the 1996 Act, the Commission should develop policies that encourage competition, and efficient competitive entry, in the markets for access services to the maximum extent possible. Competition in these markets will benefit purchasers of access services and end-user customers, because the entry of additional efficient access providers is likely to lead to the availability of lower prices and improved service.

49. Even the limited entry of alternative access providers into the access markets to date illustrates the benefits that competition can bring. In a few states in the

BellSouth region, some new entrants offer rates for switched access services that are below BellSouth's. *See* Stock Declaration, ¶ 12.

50. Competition in the access markets, however, is still in its incipiency. In many areas, competition is either nonexistent or only slowly beginning to develop. The nascent stage of competition is reflected in BellSouth's two petitions for pricing flexibility, which effectively concede that competitive alternatives exist only in a relatively small percentage of wire centers (in the case of special access and dedicated transport) and for a limited number of customer locations (in the case of switched access).

51. Moreover, in the context of switched access services, the entry of an alternative provider will not, by itself, result in lower rates or a constraint on BellSouth's pricing. As this Commission has recognized, CLECs – like ILECs – possess powerful locational advantages that insulate their rates from competitive pressures that might otherwise restrain their pricing for switched access services.[18] The ability to charge high access rates confers an enormous advantage on any LEC. It therefore cannot be assumed that CLECs offering switched access will offer competitive rates or exert competitive pressures on price cap LECs. The fact that some (but far from all) existing alternative providers of switched access nonetheless have chosen to offer lower rates is all the more reason to encourage maximum possible entry into the market for switched access, for numerous potential and actual entrants are assured to push rates lower than those charged by the ILEC.

52. As explained in Part I, the triggers established by the *Pricing Flexibility Order* would not promote competitive entry into the access markets, because they do not provide sufficient assurances that ILECs will lack market power over the access services involved. As a

result, if ILECs such as BellSouth are granted pricing flexibility like that authorized in the *Pricing Flexibility Order*, competitive entry into the access market will be deterred beyond the little entry that has already occurred, and purchasers of access services such as AT&T will be forced to pay monopoly access rates to the ILECs, resulting in higher rates to end-user customers.

1. Predatory Pricing

53. As the Commission recognized in the *Pricing Flexibility Order*, the characteristics of telecommunications markets give incumbent LECs the ability to engage in exclusionary pricing practices against new entrants. In the absence of regulatory restraints, incumbents have the ability to ward off the threat of competitive entry by "locking up" large customers by offering them volume or term discounts below entrants' costs – thereby deterring prospective entrants, for whom service to large customers may have been the inducement necessary to invest in the necessary sunk facilities. In particular, the incumbents have the ability to effectuate a price squeeze against access rivals – *i.e.*, since new entrants in the access market rarely provide service over their own facilities on an end-to-end basis, in the absence of regulatory constraints the incumbent can raise the price of the input upon which the new entrant is relying (e.g., channel terminations), while setting the price of the end-to-end service at an exclusionary level. *Pricing Flexibility Order*, ¶ 79.

54. The granting of pricing flexibility to ILECs will give them the ability to engage in such anticompetitive conduct. Phase I relief will enable the ILEC to offer volume and term discounts and contract tariffs to customers (as long as those tariffs are generally available to

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[18] First Report and Order in *Access Charge Reform,* CC Docket Nos. 96-262, *et al.*, ¶¶ 359-364 (released May 16, 1997) ("*Access Reform Order*").

similarly situated customers). Phase II relief, of course, will eliminate price caps, which protected access customers from monopoly rates. Moreover, the *Pricing Flexibility Order* removes some of the preexisting limitations on geographic deaveraging (which guard against predatory pricing and price discrimination).

55. In short, Phase I and Phase II relief will enable an ILEC to exploit and maintain its market power through a combination of predatory pricing and monopoly pricing. In those areas where the incumbent faces the threat of entry by competitive providers of switched or special access services, the Phase I relief will give the ILEC the ability and incentive to offer individualized and targeted prices well below those of its competitors – perhaps below applicable costs – for the short run, until effective competition is no longer a threat. To the extent that the competitor depends upon the ILEC as the source of one or more critical inputs needed to provide the access service (such as channel termination or dedicated transport), the ILEC will have the ability and incentive to increase the prices of the inputs in order to impose significant additional costs on its competitors.

56. As a result of these practices, alternative providers of access services will experience a substantial impairment of their ability to offer effective competition to the ILEC. In the case of a competitor that relies on the ILEC for certain critical inputs, the adverse consequences of the ILEC's predatory pricing would likely be severe. In such circumstances, the competitor would have no choice but to curtail all further expansion of facilities, because it would know that the incumbent could execute an anticompetitive price squeeze before the new entrants could build the necessary facilities.

57. Thus, as a result of the ILEC's pricing behavior, future competitive entry into the market would be deterred, and the market would be deprived of additional alternative

access providers – to the detriment of customers of access services and end-user consumers. No reasonable entrepreneur will enter a market if it believes that it has no prospect of recovering its investment, and making at least a competitive return, in the long run. Upon the entry of any new alternative provider of access services, however, the ILEC would respond with the same pattern of predatory pricing – and the alternative provider would sustain the same losses as those that would predictably be sustained by existing alternative access providers. The likelihood of such losses would surely deter prospective entrants from entering the market as facilities-based providers, because they would have no prospect of recovering the substantial sunk investment in equipment that they would be required to make. Companies that would depend on the ILEC for critical inputs would, if anything, be even more unwilling to enter the market, because the likelihood of losses would be enhanced by the unreasonable prices that they would be required to pay to the ILEC for those inputs.

58. The deterrence of additional access providers will deprive both purchasers of access and end-user customers the opportunity for lower prices and better service. Neither new entrants nor purchasers of access services have an obvious remedy for such harms. The Commission's pricing flexibility rules would have the perverse effect of choking off the development of competition, but it would be almost impossible through post hoc legal remedies to put new entrants, purchasers of access, and the public at large in the position in which they would have been had the Commission permitted competition to proceed.

2. Monopoly Pricing

59. In those areas where competition for access services does not exist, an ILEC granted pricing flexibility would have the ability and incentive to raise its access charges above price cap ceilings in those MSAs for which Phase II relief has been granted. In areas currently without competition, the ILEC could implement the price increase as soon as its

petition for pricing flexibility was approved. In those areas where competition currently exists, the ILEC could begin to charge supra-competitive prices for access services as soon as its predatory pricing practices had rendered the alternative providers incapable of providing effective competition.

60. The assessment of monopoly prices for access by ILECs will inflict irreparable harm on access purchasers and their customers. Typically, purchasers of special access services and dedicated transport and of switched access services are interexchange carriers, such as AT&T, who require access to transmit the call from a customer's premises to the IXC's point of presence or from the IXC's point of presence to the customer. Access services are an essential input for an IXC's long-distance service because, without them, an IXC can neither terminate nor originate a customer's long-distance calls.

61. The long-distance market is characterized by intense competition. Thus, the IXC would have little choice but to pass on the rate increase to its end-user customers by increasing its charges for long-distance services. That increase, however, will likely cause long-distance customers to reduce their usage of long-distance. As a result of the decrease in demand, the IXC will lose revenues and customers. By contrast, because no alternative access providers are available, the ILEC will earn higher profits from the monopoly rates paid by its captive access customers than would have been the case under the price cap regime.

62. By virtue of its incumbency and ubiquity of service, an ILEC with Phase I and Phase II pricing flexibility could deter future entry in non-competitive areas of an MSA without even lowering its rates below (possible) monopoly levels. To see how this could be accomplished, assume that some monopolistic portions of a state or MSA are presently unattractive to a potential entrant. This might be so because demand for access in these parts is

not sufficiently high to warrant or support more than one access provider. However, some other parts of the state or MSA could potentially sustain competition. Assume that the ILEC has sunk all the costs necessary to provide the access services on an statewide basis. The entrant, however, must sink some costs to provide that service and would be willing to do so only if it faced some real possibility of recouping its investment on a forward-looking basis. However, the ILEC can deter such investment by making clear that it will offer customers who require access at two sites – one in a monopolistic part of the MSA, and the other in a potentially competitive part of the MSA – the following contract: "If you purchase service at one site from me at the market price, I will provide you with the second site at (incremental) cost." The prospect of such an offer can deter entry and maintain the price of access at the monopoly level. This is because the entrant, who can only economically serve one site, realizes that if it enters, the incumbent is essentially committed to give away the service in the competitive area. Such an entrant cannot reasonably recover its sunk costs and would thus abstain from coming into the market – which would leave the ILEC able to charge the total monopoly price at both sites, with entry still foreclosed. For the same reasons, including economies of scale and scope, an ILEC could deter a prospective entrant who desires to provide service only in a single, non-competitive portion of the MSA merely by threatening to charge a low price to access customers in that area.

63. The incentive of ILECs such as BellSouth to charge monopoly prices for access rates will, if anything, be even greater once they are permitted to provide in-region long-distance services under Section 271 of the 1996 Act. Two ILECs have already received such approval from the Commission to provide such services in two states (Verizon in New York and SBC in Texas). Further, BellSouth has represented to the media that it will seek Section 271 authority for one of the states in its region during the first or second quarter of 2001 – and, once

that application is approved, BellSouth may file similar applications for the other states in its region.

64. Once it has Section 271 authority, the ILEC would have the incentive and ability to engage in an anticompetitive price squeeze as long as it remains a monopoly (or near-monopoly) provider of access services. Once ILECs such as BellSouth are permitted to provide in-region long-distance service, they will be competing with the IXCs that depend on them for the provision of terminating and originating access. This will provide the ILECs – which, with the grant of pricing flexibility, already had the ability and incentive to increase access charges to enhance their profits – with the further opportunity and incentive to weaken the IXCs' competitive position by overcharging them for access. At the same time, the increase in access charges will provide the ILECs' long-distance affiliates with a strategic cost advantage wholly unrelated to any efficiencies realized by the affiliates. The source of these cost and competitive advantages is the difference between the true cost of access, as measured by its total element long-run incremental cost ("TELRIC"), and the distorted rate that the ILEC can charge to its access customers. This cost advantage would enable the ILEC not only to charge monopoly prices for access, but to set its long-distance rates at or below its access prices.[19]

65. If access prices are above the costs that the ILEC actually incurs to provide access, the ILEC can use the cost differential between what its rivals pay them for these

[19] The Commission has long recognized that, "[a]bsent appropriate regulation, an incumbent LEC and its interexchange affiliate could potentially implement a price squeeze once the incumbent LEC began offering in-region, interexchange toll services." *Access Reform Order,* ¶ 277; *see also id.* ¶ 278 (incumbent LECs have the "incentive and ability to engage in a price squeeze"). As the Commission has explained, "[t]he incumbent LEC could do this by raising the price of interstate access services to all interexchange carriers, which would cause the competing in-region carriers to either raise their retail rates to maintain their profit margins or to attempt to maintain their market share by not raising their prices to reflect the increase in access charges." *Id.,* ¶ 277. Alternatively, "the incumbent LEC could also set its in-region, interexchange prices at or below its access prices. Its competitors would then be faced with the choice of lowering their retail rates for interexchange services, thereby reducing their profit margins, or maintaining their retail rates at the higher price and risk losing market share." *Id.*

elements and the lower economic cost that it incurs as a vertically integrated company to create an anti-competitive price squeeze and artificially gain an advantage in the provision of bundled services. This strategy will be profitable to the ILECs, while harmful to consumers, and will weaken the ability of IXCs to compete for local exchange business while maintaining the monopoly hold that the ILECs have over that business.

66. Thus, if granted pricing flexibility and Section 271 authority, ILECs will predictably use price-squeezing tactics to inflict even greater harm on IXCs and consumers. Price squeezing would impair the IXCs' ability to compete for the provision of local and long-distance service and the provision of bundles of telecommunications services that include long-distance and local exchange services. Protecting their profits from access and garnering excessive margins on bundled services jointly provide a powerful set of incentives to the ILECs to disadvantage their long-distance competitors. By maintaining above-cost access charges, the ILEC can continue to apply strong financial pressure on the IXCs, who must charge customers the levels of prices for long-distance service that reflect the excessive charges. By charging prices to its own long-distance customers that do not reflect all of the high access prices, the ILEC will be able to divert substantial business from the IXCs to itself.

67. This vertical squeeze tactic would be detrimental not only to IXCs, but also to telecommunications consumers. At first glance, it may appear that the effects of the tactic fall only on the ILEC's long-distance and bundle *competitors* who will have to match (or undercut) the ILEC's prices in order to gain or maintain market share. In fact, these misincentives have adverse impacts on *consumers*. As long as the ILEC continues to charge and collect above-cost access prices, it is the end users who will continue to pay for them in one way or another. One avenue is simply the passed-along amount that the end-user pays to the IXC, so

that the IXC can in turn pay it to the ILEC. Another avenue is the above-cost price for long-distance charged to the end-user by the ILEC. Both of these avenues of payment stand in stark and dramatic contrast to the wished-for competitive scenario in which the ILEC and IXCs compete to offer the end-user attractive bundles of services at prices which reflect no above-cost margins arising from monopoly rents.

68. Regulation will not prevent an ILEC with price flexibility and Section 271 authority from engaging in anticompetitive price squeezes. In particular, the separate affiliate and imputation requirements of Section 272 of the 1996 Act do not sufficiently eliminate competitive concerns. The requirement of Section 272(e)(3) that an RBOC impute to itself the same cost of access as it charges to its IXC competitors, while eliminating the most transparent form of discrimination, does not remedy the underlying problem of anticompetitive incentives and ability nor necessarily stop less transparent forms of access price discrimination. The transfer price recorded on the affiliated enterprise's books -- whether it is equal to or different from the access charge imposed on IXCs -- is irrelevant, because the transfer of money from one pocket of the overall business to the other pocket is irrelevant. The relevant price for detecting price discrimination is composed of the incremental cost of access plus the imputed profits, neither of which can be obtained directly from an RBOC's books, whether or not there is a separate subsidiary.

69. Finally, the ability of an ILEC to use its pricing flexibility to engage in predatory and monopoly pricing will be detrimental to interexchange carriers, such as AT&T, who sell their excess transmission capacity to other long-distance carriers. Each entrant into the access market also represents a potential long-distance carrier, because carriers in today's market desire the capability of providing both local exchange service and long-distance service to their

customers. Providing long-distance service exclusively through one's own facilities, however, requires the investment of substantial sunk costs. Many carriers are unwilling, or unable, to make an investment of that magnitude. Instead, they have been able to become long-distance carriers by purchasing excess long-distance transmission capacity from AT&T and other facilities-based interexchange carriers. That is why, although facilities-based IXCs have steadily increased in number over the years, many other IXCs are providing service as resellers.

70. Thus, the deterrence of entry into the access markets would have the effect of depriving AT&T and other facilities-based IXCs of many new customers of their long-distance transmission capacity. For AT&T, this would be a substantial loss of prospective business. I understand that AT&T currently receives substantial annual revenues from sales of its long-distance capacity to resellers. Given the popularity of resale as a method of entry into the long-distance market, it can be assumed that these revenues would grow dramatically as new companies entered the market to provide both local and long-distance service.

71. In short, by enabling ILECs such as BellSouth to engage in a combination of predatory pricing and monopoly pricing, the pricing flexibility permitted by the *Pricing Flexibility Order* would cause substantial harm to access purchasers, alternative access providers, and consumers. Such anticompetitive pricing behavior will:

- Deter additional entry into the markets for special access and dedicated transport and for switched access services, even though existing competitive alternatives in both markets are insufficient to act as a constraint on ILECs' pricing of access services.

- Severely impair the competitive abilities of existing alternative access providers, and perhaps cause the exit of some of these providers from the market.

- Increase access charges to monopoly levels, impairing the ability of interexchange carriers to compete in the long-distance market and raising long-distance rates for consumers.

- Deprive facilities-based IXCs of the opportunity for new markets for long-distance transmission capacity.

III. CONCLUSION

72. For the reasons stated, the triggers established by the *Pricing Flexibility Order* fail to ensure that, absent regulation, an ILEC granted such flexibility would be unable to exercise market power over the access services for which pricing flexibility is authorized. Instead, the triggers enable an ILEC to engage in exclusionary pricing behavior, increase rates to unreasonable levels for customers that lack competitive alternatives, and deter efficient entry into the access markets. Far from fostering competition, a grant of pricing flexibility under the Commission's current triggers will deprive the access markets of new entrants, impair the competitive abilities of alternative access providers and access customers, increase prices to consumers, and deprive interexchange carriers of additional potential markets for their excess long-distance transmission capacity. Such consequences are plainly contrary to the public interest.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief.

Executed on this 20th day of November, 2000.

Robert D. Willig

Robert D. Willig

CERTIFICATE OF SERVICE

I hereby certify that on this 21st day of November, 2000, I caused true and correct copies of the foregoing Motion of AT&T Corp. for Stay of Pricing Flexibility Order Pending Judicial Review to be served on all parties by first class mail, postage pre-paid to the addresses on the following service list.

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